Office - Supreme Court, U.S.
FILED
AUG 12 1982
ALEXANDER L. STEVAS,
CLERK

No. 82-251

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1982

ESTATE OF HARRY E. WRIGHT, JR.,
Petitioner,

VS.

UNITED STATES OF AMERICA,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

MICHAEL GARY CHATZKY
MICHAEL GARY CHATZKY,
A LAW CORPORATION
762 El Paseo de Saratoga
San Jose, CA 95130
Counsel for Petitioner

July 30, 1982

BOWNE OF SAN FRANCISCO, INC. • 180 NINTH ST. • S.F., CA 94103 • (415) 864-6500

QUESTION PRESENTED

Whether the total amount of the gross income of the petitioner estate for the tax years 1970 through 1972 was permanently set aside for a charitable purpose under the terms of its governing instrument, and was therefore fully deductible under Section 642(c) of the Internal Revenue Code of 1954, 26 U.S.C. Section 642(c).

TABLE OF CONTENTS

	Page
Question presented	1
Opinions below	1
Jurisdictional grounds in this court	1
Statutory provisions involved	2
Statement of the case	4
Argument	8
Conclusion	13
Appendix:	
Opinion, United States Court of Appeals for the Ninth Circuit	A-1
Opinion, United States District Court, Northern District of California	A-7
Judgment, United States District Court, Northern District of California	A-22
Notice of Appeal, United States District Court, Northern District of California	A-23

TABLE OF AUTHORITIES CITED

Cases

Page

Commissioner v. Citizens & Southern National Bank, 147 F.2d 977 (5th Cir. 1945) 7, 8, 10, 11, 12

Estate of J. B. Whitehead v. Commissioner of Internal Revenue, 3 T.C. 40 (1944) 6, 8, 10, 11

Lyeth v. Hoey, 305 U.S. 188 (1938) 7, 10, 11

McClung v. Commissioner, 13 B.T.A. 335 (1928) 6, 7, 9

Statutory Provisions

Revenue Act of 1932, Section 22(b)(3), 26 U.S.C. Section 22(b)(3) 10, 11

Internal Revenue Code of 1939, Section 162(a), 26 U.S.C. Section 162(a) 9, 10

Internal Revenue Code of 1954:

Section 102(a), 26 U.S.C. Section 102(a) 10, 11
Section 501(c)(3), 26 U.S.C. Section 501(c)(3) 4, 5
Section 642(c), 26 U.S.C. Section 642(c) ..i, 2, 5, 6, 7, 9, 10

28 U.S.C.:

Section 1254(1) 2
Section 1346(a)(1) 8

Federal Rules of Civil Procedure

Rule 56 6

Textbooks

5 Mertens, *Law of Federal Income Taxation*, Section 31.01 12

Ferguson, Freeland, and Stephens, *Federal Income Taxation of Estates and Beneficiaries* (1970), page 358 12

No.

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1982

ESTATE OF HARRY E. WRIGHT, JR.,
Petitioner,

VS.

UNITED STATES OF AMERICA,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

The petitioner, Estate of Harry E. Wright, Jr., respectfully prays for the issuance of a writ of certiorari to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit entered on May 14, 1982.

OPINIONS BELOW

The opinions of the United States Court of Appeals for the Ninth Circuit and the United States District Court for the Northern District of California, each of which was reported, appear in the Appendix hereto.

JURISDICTIONAL GROUNDS IN THIS COURT

The judgment of the Court of Appeals for the Ninth Circuit was made and entered on May 14, 1982, and a copy thereof is appended to this Petition in the Appendix hereto.

The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

STATUTORY PROVISIONS INVOLVED

26 U.S.C. Section 642(c) (Section 642(c) of the Internal Revenue Code of 1954): "DEDUCTION FOR AMOUNTS PAID OR PERMANENTLY SET ASIDE FOR A CHARITABLE PURPOSE. — (1) GENERAL RULE. — In the case of an estate or trust (other than a trust meeting the specifications of subpart B), there shall be allowed as a deduction in computing its taxable income (in lieu of the deduction allowed by section 170(a), relating to deduction for charitable, etc., contributions and gifts) any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid for a purpose specified in section 170(c) (determined without regard to section 170(c)(2)(A)). If a charitable contribution is paid after the close of such taxable year and on or before the last day of the year following the close of such taxable year, then the trustee or administrator may elect to treat such contribution as paid during such taxable year. The election shall be made at such time and in such manner as the Secretary prescribes by regulations.

"(2) AMOUNTS PERMANENTLY SET ASIDE. — In the case of an estate, and in the case of a trust (other than a trust meeting the specifications of subpart B) required by the terms of its governing instrument to set aside amounts which was —

(A) created on or before October 9, 1969, if —

(i) an irrevocable remainder interest is transferred to or for the use of an organization described in section 170(c), or

(ii) the grantor is at all times after October 9, 1969, under a mental disability to change the terms of the trust; or

(B) established by a will executed on or before October 9, 1969, if —

(i) the testator dies before October 9, 1972, without having republished the will after October 9, 1969, by codicil or otherwise,

(ii) the testator at no time after October 9, 1969, had the right to change the portions of the will which pertain to the trust, or

(iii) the will is not republished by codicil or otherwise before October 9, 1972, and the testator is on such date and at all times thereafter under a mental disability to republish the will by codicil or otherwise,

there shall also be allowable as a deduction in computing its taxable income any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, permanently set aside for a purpose specified in section 170(c), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acuisition, maintenance, or operation of a public cemetery not operated for profit. In the case of a trust, the preceding sentence shall apply only to gross income earned with respect to amounts transferred to the trust before October 9, 1969, or transferred under a will to which subparagraph (B) applies. . . ."

STATEMENT OF THE CASE

The parties have fully stipulated the material facts of the case. The case does not involve a factual dispute. It concerns an interpretation of the relevant statutory and decisional principles governing the facts.

The basic facts are as follows:

Harry E. Wright, Jr. (hereinafter referred to as "Wright") died on November 11, 1969. He left a will dated June 20, 1969, that specifically disinherited his sister, Earline Wright Torecellan (hereinafter referred to as "Torecellan"). After making certain specific bequests, the will directed that the residue of the Estate was to be distributed to such charitable, educational, or other worthy recipients as Wright's attorneys and executors shall select.

The executor of Wright's Estate filed a petition to probate Wright's will in the California Superior Court for the County of Santa Clara. However, Torecellan filed a will contest opposing the probate of the will.

The Harry E. Wright, Jr. Charitable Trust (hereinafter referred to as "Charitable Trust") was subsequently established. It qualified with the Internal Revenue Service as a charitable organization that was tax-exempt under Section 501(c)(3) of the Internal Revenue Code (26 U.S.C. Section 501(c)(3)). The Charitable Trust was the appointee of the entire residuary Estate of petitioner.

On April 28, 1972, Torecellan, John Thorne (the executor of the petitioner), and the Charitable Trust entered into a Compromise and Settlement Agreement of Torecellan's will contest. Subsequently, the probate court entered an order admitting the will to probate.

On August 3, 1972, Torecellan died. Shortly thereafter, the Charitable Trust and United California Bank (as Torecellan's executor) entered into a new settlement agreement which provided that the entire residuary estate of the petitioner was to be equally divided between the Charitable Trust and Torecellan's Estate. This new settlement agreement was approved by the probate court on April 10, 1973.

The probate court entered an order for partial preliminary distribution of the petitioner under which John Thorne was ordered to pay the sum of Five Hundred Thousand Dollars ($500,000) each to the Estate of Torecellan and to the Charitable Trust, constituting partial distributions of their respective fifty percent (50%) residuary interests under the settlement agreement.

Thereafter, on November 14, 1973, the Superior Court for the County of Santa Clara rendered and entered a declaratory judgment which provided in pertinent part that the Charitable Trust was the residuary legatee of petitioner, that the residuary clause in the will provided for the appointment of the residuary estate only to a properly qualified tax-exempt entity under Internal Revenue Code Section 501(c)(3), and that the Charitable Trust was a properly operating and qualified tax-exempt entity under such Internal Revenue Code section. The declaratory judgment matter was presented in an uncontested manner.

In its amended tax returns, the petitioner claimed a charitable deduction under Internal Revenue Code Section 642(c) in an amount equal to only fifty percent (50%)

of the gross income earned by the Estate during the years 1970 and 1971. The basis for this amount was that fifty percent (50%) of the residuary estate was to be distributed to Torecellan's Estate, a non-charitable interest. Similarly, the 1972 income tax return of the petitioner claimed a charitable deduction for only fifty percent (50%) of its gross income for that year.

During 1974, the petitioner filed re-amended income tax returns for the years 1970, 1971, and 1972 which sought a refund of income taxes paid on the basis that all of the gross income earned by the petitioner during those years (rather than 50% of such income) constituted a charitable deduction under Internal Revenue Code Section 642(c).

The Internal Revenue Service denied this claim for refund on November 28, 1978. Consequently, the petitioner filed the action herein before the United States District Court for the Northern District of California seeking a refund of such income taxes, together with interest thereon.

The matter was presented before the United States District Court on cross-motions for summary judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure.

The District Court granted the respondent's motion for summary judgment and dismissed petitioner's complaint with prejudice. Petitioner's motion for summary judgment was thus denied by the District Court below.

Before the District Court, the petitioner largely rested its case on the cases of *McClung v. Commissioner*, 13 B.T.A. 335 (1928) and *Estate of J.B. Whitehead v. Commissioner of Internal Revenue*, 3 T.C. 40 (1944), affirmed

sub nomine in *Commissioner v. Citizens and Southern National Bank*, 147 F.2d 977 (5th Cir. 1945). These cases involved facts that were remarkably similar to those in petitioner's case. They presented the same legal issue. The courts in each of these cases decided in favor of the taxpayer, adopting the same rationale that the petitioner presented to the courts below in support of its position in this case.

Nonetheless, the respondent contended, and the District Court agreed, that *McClung* was effectively overruled by the United States Supreme Court decision in *Lyeth v. Hoey*, 305 U.S. 188 (1938). The District Court thus found that the petitioner's gross income was not permanently set aside for the years in question until the settlement agreement became final. Thus, only that amount actually paid to the Charitable Trust, equivalent to fifty percent (50%) of the residuary estate, was found to have been properly deductible under Internal Revenue Code Section 642(c), rather than one hundred percent (100%) of the residuary estate which petitioner claimed was permanently set aside.

On appeal, the United States Court of Appeals for the Ninth Circuit affirmed the decision of the District Court. The Court of Appeals found that although *Lyeth v. Hoey* was not decided under the provision of the Internal Revenue Code at issue in this case and it thus does not overrule *McClung v. Commissioner*, the rationale of the court in *Lyeth v. Hoey* was persuasive and applicable to the facts of this case.

Neither the United States District Court below nor the United States Court of Appeals for the Ninth Circuit discussed the applicability of the *Whitehead* and *Citizens and Southern National Bank* decisions to the facts of petitioner's case.

The District Court for the Northern District of California had jurisdiction over this case under 28 U.S.C. Section 1346(a)(1).

ARGUMENT

The decision below should be reviewed because it directly conflicts with the decision of the United States Court of Appeals for the Fifth Circuit in *Commissioner v. Citizens and Southern National Bank*, 147 F.2d 977 (5th Cir. 1945) concerning the same legal issue.

To reconcile this conflict, and thus afford all United States taxpayers with uniform treatment, it is necessary for the United States Supreme Court to review this case on a writ of certiorari.

In *Citizens and Southern National Bank*, the decedent left his entire estate to a corporation that was to be formed for charitable and educational purposes, subject to the payment of two special bequests and two annuities.

The decedent's widow filed a will contest under which she claimed the entire estate as the sole heir. Her demands were settled under a settlement agreement that paid her the sum of $500,000 (plus sums payable to her under a previous separation agreement).

The charitable and educational corporation was organized two years after the death of the decedent.

The estate contended that its gross income (except the amount paid upon the two special bequests) was entirely deductible because under Section 162(a) of the 1939 Internal Revenue Code (the predecessor to Section 642(c) of the Internal Revenue Code of 1954) the gross income of the estate was, under the will, paid or permanently set aside to a charitable corporation with such gross income to be used exclusively for charitable or educational purposes.

The Internal Revenue Service disagreed and contended that, *inter alia*, the will did not provide for the use of the gross income *exclusively* for charitable or educational purposes.

Both the Tax Court and the United States Court of Appeals for the Fifth Circuit held for the taxpayer. The Tax Court, in a lengthy opinion that thoroughly analyzed the issues, cited and incorporated the case of *McClung v. Commissioner*, 13 B.T.A. 335 (1928) in its decision. The Tax Court stated:

> *"In Hu L. McClung et al., executors*, 13 B.T.A. 335, we said executors could not by their acts change the directions contained in the will. We therefore look to the terms of the will, and apply them to the statute involved." (3 T.C. 40, 49.)

The Tax Court found that it was the testator's intent to devote his estate to charitable or educational uses after the discharge of the special bequests and his contractual obligations. The Court treated the payment of the $500,000 to the widow in settlement of her claim as being *immaterial* to its deductibility under Internal Revenue Code Section

162(a), the predecessor to Internal Revenue Code Section 642(c), the statute that is in issue in petitioner's case. The Court stated:

> ". . . In this matter, the widow was paid $500,000 additional in settlement of her claim to the entire estate. The payment of her claim is not material." (3 T.C. 40, 52.)

Thus, in *Estate of J. B. Whitehead v. Commissioner of Internal Revenue*, 3 T.C. 40 (1944), affirmed *sub nomine* in *Commissioner v. Citizens and Southern National Bank*, 147 F.2d 977 (5th Cir. 1945), the $500,000 payment to the widow under the will contest settlement agreement did not affect the deductibility of the *entire* gross income of the estate under the predecessor statute to the statute at issue in petitioner's case.

The opinion of the United States Court of Appeals for the Ninth Circuit below does not mention the decisions in *Whitehead* and *Citizens and Southern National Bank*. Instead, the Ninth Circuit opines that the reasoning of the United States Supreme Court in *Lyeth v. Hoey*, 305 U.S. 188, 59 S.Ct. 155 (1938) was persuasive and the Ninth Circuit thus elected to follow it. *Lyeth* involved a compromised will contest that involved an entirely different statute than the one presented by the petitioner's case. The issue in *Lyeth* was whether the contesting relative was entitled to treat the funds he received pursuant to the settlement as a tax-exempt "inheritance" under Section 22(b)(3) of the Revenue Act of 1932 (26 U.S.C. Section 22(b)(3), which is the predecessor of Section 102(a) of the Internal Revenue Code of 1954 (26 U.S.C. Section

102(a)). The Court held that the funds received through the settlement agreement constituted a tax-exempt inheritance. In reaching this conclusion, interpreting the applicability of the tax-exempt inheritance statute to the facts of that case, the Supreme Court held that federal law rather than state law should apply.

The petitioner has steadfastly argued, both before the District Court and the Court of Appeals below, that *Lyeth* does not apply to the issue raised by petitioner's case. The petitioner has argued that *Lyeth* involves a judicial interpretation of the word "inheritance" under Section 22(b)(3) of the Revenue Act of 1932. Neither that statute, nor its successor statute, is in issue in petitioner's case. In *Lyeth*, the Court examined the legislative history of that statute and found that the heir acquired the property because of his heirship and thus should be held to have received the property pursuant to the tax exemption granted to the recipients of inheritances.

Lyeth was decided in 1938. The Tax Court decided *Whitehead* in 1944, approximately six years after the decision in *Lyeth*. *Lyeth* was affirmed in *Citizens and Southern National Bank* in 1945.

Thus, neither the Tax Court nor the United States Court of Appeals for the Fifth Circuit applied the decision in *Lyeth* to facts that parallel those of the petitioner's case.

Petitioner thus contends that there are two contrary lines of cases existing in our country that conern the issue presented by this case. This duplicity should be eliminated to streamline and unify the enforcement of our tax laws.

Petitioner further contends that a more equitable, fair, and correct tax result is produced by the line of cases represented by the Fifth Circuit decision in *Citizens and Southern National Bank* than the decision of the Ninth Circuit below in this case. The Fifth Circuit result is more consistent with the legislative policy of Congress to liberally promote charitable contributions. For instance, please see 5 Mertens, *Law of Federal Income Taxation*, Section 31.01, wherein it is stated in pertinent and applicable part:

> "It has been a consistent legislative policy ever since the 1917 Act to permit the deduction of so-called charitable contributions.
>
> "The purpose is no doubt to encourage such contributions, and the provision allowing the deduction is not to be narrowly construed."

Furthermore, even the Ninth Circuit in its opinion below concedes the criticism of its own tax policy which may hamper the administration of estates by leaving characterization of their funds in limbo during the pendency of a will contest. The Ninth Circuit opinion provides an example of such criticism from the text *Federal Income Taxation of Estates and Beneficiaries* 358 (1970), coauthored by M. Ferguson, J. Freeland, and R. Stephens. As reported by the Ninth Circuit, the authors state:

> "As a matter of logic, (this position) would lead to the result that no charitable deduction could ever be allowed for income accumulated or gains allocated to corpus for years in which any outside force seriously threatened the ultimate charitable use. This would mean that whenever the validity of the will was attacked or whenever there were substantial claims against the estate, no deduction could be claimed, except for amounts actually paid out for charity. Even

> though the charities' right were ultimately found to be substantial this would foreclose the deduction, at least in the early period of administration for a great many estates. It is very doubtful Congress intended the deduction to be so restricted."

Thus, granting this writ of certiorari will resolve this conflict between the Courts of Appeals for the Fifth Circuit and the Ninth Circuit, providing a uniform tax treatment to all U.S. taxpayers in the process. Granting the petition for a writ of certiorari will also permit taxpayers in the Ninth Circuit to have the opportunity to attain a more equitable tax treatment with respect to their charitable contributions, coinciding with the liberal Congressional policy that encourages charitable contributions.

CONCLUSION

For the reasons set forth above, it is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted,

MICHAEL GARY CHATZKY
MICHAEL GARY CHATZKY,
A LAW CORPORATION

July 30, 1982

(Appendix follows)